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PETITION AND BRIEF.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941

No. [redacted] 109

SWASTIKA OIL AND GAS COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

Filed ....., 1942

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ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The above petitioner prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Sixth Circuit, entered November 6, 1941, affirming the order of the Board of Tax Appeals holding that the sum of $53,146.52 received by petitioner in settlement of certain litigation during petitioner's fiscal year ending October 31, 1935, was income for that year.

Petitioner's motion for a rehearing seasonably made was denied on March 3, 1942.

STATUTES INVOLVED.

Revenue Act of 1934, C. 277, 48 Stat. 680:

Sec. 22. *Gross Income.*

(a) General definition.—"Gross income" includes gains, profits, and income derived from * * * sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from * * * the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * *

(U. S. C., Title 26, Sec. 22.)

Sec. 41. *General Rule.*

The net income shall be computed upon the basis of the taxpayer's annual accounting period * * * in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; * * *.

* * *

(U. S. C., Title 26, Sec. 41.)

Sec. 42. *Period in which items of gross income included.*

The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

Questions Involved.

A. Was the sum of $53,146.52 received by petitioner in settlement of pending litigation during the fiscal year ending October 31, 1935, compensation for injury to or destruction of incorporeal assets and therefore nontaxable?

B. Was the said sum in the nature of a penalty assessed against faithless fiduciaries and, therefore, nontaxable?

C. Was the said sum taxable for the year 1935, petitioner having at all times kept its books on an accrual basis, and its right to said sum having become absolutely fixed and determined during the year 1933?

The Commissioner of Internal Revenue held that said sum constituted income to petitioner for that taxable year; the Board of Tax Appeals sustained the Commissioner's assessment, and the Circuit Court of Appeals affirmed the order of the Board of Tax Appeals.

Statement.

The facts in this case are not fully set forth in the opinion of the Circuit Court of Appeals (R. 67-71).

The admitted facts are briefly as follows:

The respondent determined a deficiency in the petitioner's income tax returns for the taxable year ending October 31, 1935 (R. 54-56). It was based upon the receipt by the petitioner of a sum in compromise settlement

of litigation pursued by the petitioner in the Circuit Court of Muskegon County, Michigan (R. 6-9). Petitioner has always kept its book on the accrual basis of accounting (R. 3-5). This case was tried before the Board of Tax Appeals (R. 16-32). Respondent offered no evidence other than petitioner's income tax report for its fiscal year ending October 31, 1935 (R. 31, 54-56).

The petitioner, having title to oil lands in Muskegon, Michigan, entered into a contract on April 19, 1929, with one J. D. Wrather, for the building of a refinery thereon, to cost $75,000.00 (Pet. Ex. 1, R. 23, 24, 36, 38). By its terms the petitioner was to sell Wrather all of the crude oil produced by its wells with an agreement that whenever the cost of the refinery should be paid out of the profits of its operation the petitioner was to receive a 35 per cent interest therein, and if a corporation was organized to take it over, it was to receive 35 per cent of its stock (R. 23, 24). Wrather built the refinery and transferred it to a corporation styled the Michigan Central Refining Company, a Michigan corporation, in which defendants Wrather, Maguire and Caldwell were controlling stockholders, directors and officers (Pet. Ex. 1-2, R. 24, 38, 39). The corporation assumed Wrather's contract with petitioner. The petitioner furnished it with oil until May 28, 1930, when Wrather and his fellow controlling stockholders, directors and officers, Caldwell and Maguire, secretly caused the Michigan Central assets to be transferred to the Roosevelt Oil Company (in which Maguire and Caldwell were also the controlling stockholders, directors and officers), the refinery to be moved from Muskegon, Michigan, to Mt. Pleasant, Michigan, and the Michigan Central Refining Company to be dissolved (R. 24-26). Later Maguire and Caldwell secretly caused the Roosevelt Oil Company to enter into contracts for the sale and distribution of its

products to and through the Simrall Pipe Line Company and the Northland Oil Company, other corporations which they also controlled, resulting in large secret profits to them and their nominees.

Wrather, Maguire and Caldwell, as majority stockholders, directors and officers of both the Michigan Central Refining Company, the seller, and the Roosevelt Oil Company, the buyer, occupied a fiduciary relationship toward petitioner (Plf. in the Michigan court).

At the time of the removal of the refinery from Muskegon, $39,000.00 of its original cost had been paid out of the profits of the Michigan Central Refining Company earned in 1929 and 1930 (R. 25). The remaining $36,000.00 was paid out of the profits of the Roosevelt Oil Company in the period 1930 to 1933 (R. 18, 28, 29).

The Roosevelt Oil Company, which took over the assets of the Michigan Central Refining Company, showed by its financial statement for September, 1933, total assets of approximately $493,000.00 (Pet. Ex. 10, R. 29, 52-54). Petitioner's interest in said Roosevelt Oil Company was reasonably worth $90,000.00 at that time (R. 30).

On May 19, 1931, the petitioner filed a bill of complaint in equity in the Circuit Court of Muskegon County, Michigan, seeking to impress a trust upon the capital stock of of the Roosevelt Oil Company to the extent that it was entitled to have received stock in the Michigan Central Refining Company. In the alternative it sought to set aside the dissolution of the Michigan Central, to procure the transfer to it of all of the Roosevelt Oil Company assets, and the execution and delivery to the petitioner of its agreed share of Michigan Central capital stock. It

also sought an accounting on behalf of Michigan Central of the secret profits made by the promoters in the transactions between Roosevelt Oil Company and other corporations (Pet. Ex. 1-7, R. 32-43). The trial court filed his opinion on January 23, 1935 (Pet. Ex. 8, R. 43-48), and a decree followed on February 28, 1935, substantially granting the petitioner's claim to relief (Pet. Ex. 9, R. 48-52). The dissolution of the Michigan Central Refining Company and the sale of its assets, were held null and void, and the plaintiff adjudged entitled to 35 per cent of the shares of Michigan Central stock and *that company* was held to be entitled to an accounting of the profits derived by the Roosevelt Oil Company, and the other companies controlled by defendants, Maguire and Caldwell (Pet. Ex. 9, R. 48-52).

The defendants in the state court litigation prepared to take an appeal to the Michigan Supreme Court, but later agreed upon a settlement pursuant to which the petitioner, in September, 1935, received a cash payment of $80,000.00 in full settlement of its claims. The respondent allowed a deduction of the legal and other expenses incurred in the prosecution of the suit; and asserted a deficiency in the petitioner's taxable income for 1935 of $53,146.52. This deficiency was contested before the Board of Tax Appeals which sustained the Commissioner. On petition for review of the Board's decision (R. 57-63) the Circuit Court of Appeals affirmed the same (R. 67-71).

Reasons For Granting the Writ.

1. In the case of *Farmers and Merchants Bank* v. *Commissioner*, 59 Fed. (2) 912, Mr. Justice Hicks, speaking for the Circuit Court of Appeals for the Sixth Circuit, said

"We can see no legal distinction between compensation for *destruction of* or *damage to* incorporeal or intangible property" and held that an amount received in settlement of a *tortious injury* to one asset (good will) of a taxpayer does not constitute income upon any logical basis. On the contrary Mr. Justice Simons, speaking for the same court in the case at bar, holds that a *total destruction* of another incorporeal or intangible asset (right to receive stock in a company tortiously dissolved) does constitute income. In other words, an amount received in settlement for *an injury to an asset* is not income, while a like settlement for the *total destruction of an asset* is income.

2. The opinion of the Circuit Court of Appeals in the case at bar is directly in conflict with the opinion of this court in the case of *U. S.* v. *Safety Car Heating & Lighting Co.*, 297 U. S. 88, where it said on page 98:

> "The case is not to be confused with one where the basis of the suit is an injury to capital with the result that recovery is never income no matter when collected."

3. In the case of *Central Railroad Co. of N. J.* v. *Commissioner*, 79 Fed. (2) 697, where the material facts and legal principles involved are practically identical with those in the case at bar, the Circuit Court of Appeals for the Third Circuit, specifically approved and followed the decision of the Sixth Circuit in the *Farmers & Merchants Bank* case, 59 Fed. (2) 912, quoted Mr. Justice Hick's language "The fund involved must be considered in the light of the claim from which it was realized", and thereupon held that the amount received in settlement of a suit against faithless fiduciaries in that case did not constitute income because it was in the nature of a penalty assessed against faithless fiduciaries. Both the Board of Tax Ap-

peals and the Circuit Court of Appeals entirely overlooked the *Central Railroad Company* case.

4. There is no difference between the fiduciary relationship which existed between Joyce as managing agent of the Central Railroad Company of New Jersey, 79 Fed. (2) 697, who organized secret companies to deal with his own company, and that fiduciary relationship which existed between petitioner and Maguire, Caldwell and Wrather, who wrecked, destroyed and illegally dissolved the Michigan Central Refining Company, of which they were majority stockholders, directors and controlling officers, by secretly selling that company's assets to the Roosevelt Oil Company, which they also controlled in a like manner. Furthermore they injured, yes, *destroyed,* the capital stock in Michigan Central Refining Company to which plaintiff was legally entitled to the same extent that the defendant in the *Farmers & Merchants Bank* case 59 Fed. (2) 912 injured the latter's good will.

The decision of the Circuit Court of Appeals for the Third Circuit in the case of *Central Railroad Company of New Jersey* v. *Commissioner,* 79 Fed. (2) 697 holding that money recovered from a faithless fiduciary does not constitute income is directly in conflict with the decision of the Sixth Circuit in the case at bar.

5. Although it is admitted and the Circuit Court of Appeals states (R. 70) that petitioner kept its books on an accrual basis, and although it is admitted and that Court states (R. 68) that the profits of the Roosevelt Oil Company absolutely entitled petitioner to 35 per cent of the Michigan Central stock as early as the year 1933 yet the Circuit Court of Appeals holds that the amount received for the stock to which it was admittedly entitled in 1933 was income in 1935 (R. 69).

6. The decisions of the several Circuits of the Court of Appeals already rendered on the material questions of evidence and law involved here are confusing, difficult, if not impossible, of reconciliation and do not appear to be applying uniform tests of principle.

7. This Court has never decided whether an amount received by a taxpayer in settlement of a suit brought for the recovery of property misappropriated by faithless fiduciaries constitutes income.

Wherefore, it is respectfully submitted that this petition should be granted.

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